

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>HONG J. HAN</b>	:	DETERMINATION
	:	DTA NO. 819092
for Revision of a Determination or for Refund of Sales and	:	
Use Taxes under Articles 28 and 29 of the Tax Law for the	:	
Period September 1, 1996 through August 31, 1999.	:	

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Petitioner, Hong J. Han, 12 Timberline Drive, Alpine, New Jersey 07620, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1996 through August 31, 1999.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on April 29, 2003 at 10:30 A.M., and continued to conclusion at the same location on September 23, 2003 at 10:30 A.M., with all briefs to be submitted by August 2, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared *pro se* at hearing, and by Ballon Stoll Baker & Nadler, P.C. (Chris Mularadelis, Esq., of counsel) on the briefs. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Michael P. McKinley, Esq., of counsel).

## ***ISSUES***

I. Whether the Division of Taxation properly determined that petitioner was personally liable for sales tax due on behalf of Nah Nah Collection, Inc., as a person required to collect and pay tax under Tax Law §§ 1131 and 1133.

II. Whether the audit method used by the Division of Taxation was reasonably calculated to determine the company's sales tax liability for which petitioner was held personally liable.

III. Whether petitioner has established that the company's failure and his failure to properly report and pay sales and use taxes was due to reasonable cause.

## ***FINDINGS OF FACT***<sup>1</sup>

1. Nah Nah Collection, Inc. ("Nah Nah"), a woman's garment manufacturing company, was established in 1988 and eventually operated from two Manhattan locations. The company sold its products wholesale and did not make retail sales. On December 24, 1997, Nah Nah merged with a public company referred to as Hero Group LTD., and in 1998 the company was renamed Nahdree Group, Inc. ("Nahdree"). Nah Nah thereafter operated as a subsidiary of Nahdree.

2. After incurring some cash flow problems, on June 18, 1999, Nahdree filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code, and Nah Nah was one of thirteen subsidiaries of Nahdree included in the filing. Jack M. Zackin, Esq., was appointed as the bankruptcy trustee.

3. In July 1999, petitioner, Hong J. Han, formerly the chief executive officer of Nahdree, was dismissed from his employment by the company.

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<sup>1</sup> The Division of Taxation's proposed findings of fact are incorporated herein.

4. The Division of Taxation (“Division”) sent correspondence to Nah Nah dated July 16, 1999, scheduling a field audit appointment for August 12, 1999 at Nah Nah’s place of business, 213 W. 35<sup>th</sup> Street, New York, New York. The appointment letter requested all books and records pertaining to Nah Nah’s sales and use tax liability for the period under audit, September 1, 1996 through May 31, 1999. A list of records to be presented included the general ledger, cash receipts journal, cash disbursements journal, Federal income tax returns, sales tax returns, merchandise purchase invoices, sales invoices, expense purchase invoices, fixed asset purchase invoices, bank statements, exemption documents supporting nontaxable sales, and general journal and closing entries, for the entire audit period.

The appointment letter was mailed to Nah Nah return receipt requested, and the return postal card was delivered to the Division indicating the company received the letter on July 19, 1999. Nah Nah never responded to the appointment letter and did not provide the Division with any of the books and records requested.

At some point during the audit, the Division extended the audit period to include June 1, 1999 through August 31, 1999. There was no evidence introduced that the Division requested production of Nah Nah’s books and records for the extended audit period, the period after May 31, 1999.

5. On August 12, 1999, the Division’s auditor in this case visited Nahdree’s business locations and became aware that the company had gone out of business.

6. The Division, unable to obtain Nah Nah’s books and records, had the sales tax returns filed by Nah Nah as its only reference to current company records.

7. Nah Nah was involved in a prior sales tax field audit by the Division which covered the period September 1, 1990 through May 31, 1994. The company had consented to additional

sales tax assessed in the amount of \$14,735.33 which was comprised of \$5,545.96 of sales tax on purchases of tangible personal property (fixed assets) on which no tax was paid, and \$9,189.37 use tax due on expense purchases for advertising, office supplies and expenses and service contracts on which tax was not paid.

The fixed asset purchases assessed in the amount of \$67,224.00 in relation to the gross sales per the returns filed by Nah Nah in the prior audit period of \$52,368,411.00 resulted in an error rate percentage of .1284%. Likewise, the Division determined that expense purchases assessed in the prior audit upon which tax was not properly paid was \$111,387.00. This amount in relation to sales over the audit period of \$52,368,411.00 resulted in an error rate percentage of .2127%.

8. The percentages from the prior audit were applied to the sales reported by Nah Nah on its sales tax returns in the current audit period. By utilizing the sales tax returns, the Division applied the percentage of unpaid sales tax on fixed assets (.1284%) from the prior audit to gross sales per quarter beginning with September 1, 1996 in the current audit period. Where returns were filed on an annual basis, the gross sales per quarter were calculated by dividing the annual sales by four. For the five quarters from June 1, 1998 through August 31, 1999, when no returns were filed, the Division estimated the quarterly gross sales based on the previously filed annual report in the period immediately preceding these five quarters. After the application of the 8.25% tax rate, the Division estimated that tax due on fixed assets for the audit period was \$8,319.94.

Likewise, as to expense purchases, by utilizing the sales tax returns, the Division applied the percentage of unpaid sales tax on expense purchases (.2127%) from the prior audit to gross sales per quarter beginning with September 1, 1996 in the current audit period, through August

31, 1999. After the application of the applicable 8.25% tax rate, the Division estimated that tax due on expense purchases for the audit period was \$13,782.33. The company's total liability as computed by the Division was \$22,102.27, and Nah Nah was assessed accordingly.

The Division received the company's gross sales information for the period June 1, 1997 through May 31, 1998 only after it had sent a Notice of Non-Receipt of Sales and Use Tax Return to Nah Nah.

9. The Division issued a Notice of Determination to petitioner, dated December 6, 1999, indicating he was being held responsible as an officer of Nah Nah for sales and use taxes for the period September 1, 1996 through August 31, 1999. Assessment L-017198887-5 was issued asserting additional sales and use tax in the amount of \$22,102.29,<sup>2</sup> plus interest and penalty of \$5,031.83 and \$5,596.36, respectively, for a balance due of \$32,730.48.

10. A New York State Department of State Biennial Statement for the filing period of December 1996 indicates petitioner was chairman of the board of directors of Nah Nah, whose corporate address is 213 W. 35<sup>th</sup> Street, New York, New York.

11. Petitioner's Forms W-2 for tax years 1996 and 1997 indicate wages earned by petitioner from Nah Nah in the amounts of \$470,094.80 and \$460,094.80, respectively. Petitioner received two Forms W-2 in 1998: one from Nah Nah in the amount of \$295,939.69, and the other from Nahdree Group, Inc. ("Nahdree") in the amount of \$184,674.83.

12. Corporate tax returns of Nah Nah for tax years July 1, 1996 through June 30, 1997, and July 1, 1997 through December 23, 1997, respectively, indicate petitioner was Nah Nah's president (by his signature dated March 15, 1998) and a 100% shareholder.

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<sup>2</sup> Difference due to rounding.

13. By a letter dated January 20, 2000 from Jeffrey Rich, Esq., petitioner requested a conference with the Bureau of Conciliation and Mediation Services (“BCMS”). In his letter to BCMS, Jeffrey Rich, Esq., of Winick & Rich, indicated that he was forwarding a copy of the Notice of Determination at issue herein to Nah Nah’s bankruptcy trustee, Mr. Zackin, who he understood would forward the same to the accountants for the trustee.

In correspondence from Elizabeth Singer, Esq., of Winick & Rich, to the bankruptcy trustee, Ms. Singer requested copies of Nah Nah’s tax returns and SEC filings for the audit period.

14. A copy of a letter dated May 7, 2003 from petitioner to Mr. Zackin was submitted into evidence requesting that the trustee allow the Division access to the necessary documentation for the audit matter. Attached to the letter was the checklist of records Nah Nah was requested to provide for the audit. Petitioner did not receive a response to this letter.

15. Post-hearing, the Division similarly corresponded with the bankruptcy trustee in an attempt to obtain access to Nah Nah’s business records by its correspondence of May 13, 2003. The Division did not receive a response from the trustee.

16. At the request of petitioner, the Division of Tax Appeals provided petitioner with a subpoena duces tecum for petitioner to serve on the bankruptcy trustee to acquire Nah Nah’s business records. In correspondence dated July 17, 2003, the administrative law judge herein emphasized that the subpoena must be properly served in accordance with the Tax Appeals Tribunal Rules of Practice and Procedure. Petitioner mailed the subpoena to Mr. Zackin by certified mail return receipt requested on September 11, 2003, along with his correspondence to the bankruptcy trustee dated September 9, 2003, requesting Nah Nah’s books and records. A copy of the United States Postal Service Certified Mail Receipt was introduced into the record.

***SUMMARY OF THE PARTIES' POSITIONS***

17. Petitioner claims he had no authority to provide books and records of Nah Nah to the Division because he was forced to resign, and requested the bankruptcy trustee, Mr. Zackin, to provide the items for the Division's review. Petitioner maintains he made sufficient efforts to obtain possession of Nah Nah's books and records and should not be penalized for his inability to produce them for reasons beyond his control. Petitioner maintains that the request for documents should have been directed to the trustee, the only person with authority to produce them.

Petitioner argues that the audit methodology used by the Division was flawed for numerous reasons and should not be considered reliable.

Petitioner claims he is not a responsible party for the tax, since he could not produce the documents.

18. The Division maintains that petitioner is a person responsible for the collection of tax. The Division also argues that the audit method used by the Division was reasonably calculated to determine the company's sales tax liability.

***CONCLUSIONS OF LAW***

A. Tax Law § 1133(a) imposes upon any person required to collect the tax imposed by Article 28 of the Tax Law personal liability for the tax imposed, collected or required to be collected. A person required to collect tax is defined to include, among others, corporate officers and employees who are under a duty to act for such corporation in complying with the requirements of Article 28 (Tax Law § 1131[1]). In order for petitioner to prevail in this case, petitioner was required to establish by clear and convincing evidence that he was not an officer having a duty to act on behalf of the corporation, i.e., that he lacked the necessary authority or he

had the necessary authority, but was thwarted by others in carrying out his corporate duties through no fault of his own (*Matter of Goodfriend*, Tax Appeals Tribunal, January 15, 1998). Neither of these circumstances accurately describes the facts of this case. Petitioner was a 100% shareholder of Nah Nah, its president, chairman of the board, and signatory of important corporate documents. Given these facts the Division properly determined that petitioner was personally liable for such taxes.

Additionally, petitioner's liability as a responsible officer of the corporation is separate and distinct from that of the corporation (*Matter of Mustafa*, Tax Appeals Tribunal, December 27, 1991). As the Tribunal stated in that case:

[c]ase law similarly distinguishes between the liability of the corporate entity and that of its responsible officer(s). The Third Department in *Matter of Yellin v. New York State Tax Commn.* (81 AD2d 196, 440 NYS2d 382, 383-384) held that even though the Commission had failed to set off a certain claim against a bankrupt corporation's refund, it could still collect this amount from the individual petitioner (*see also, Monday v. United States*, 421 F2d 1210, 70-1 USTC ¶ 9205 at 82,833, *cert denied* 400 US 821; *Spivak v. United States*, 370 F2d 612, 614-615, 67-1 USTC ¶ 9158, *cert denied* 387 US 908). In another bankruptcy case, we applied *Yellin's* premise, holding that a corporate officer was not absolved of personal liability 'by virtue of the corporation's bankruptcy,' because 'the general rule is that the liability of a responsible officer is separate and independent from that of the corporation' (*Matter of Kadish*, Tax Appeals Tribunal, November 15, 1990; *see also, Matter of Halperin v. Chu*, 134 Misc 2d 105, 509 NYS2d 692, *affd* 138 AD2d 915, 526 NYS2d 660 [issue of personal liability of individual petitioner cannot be reviewed in application of corporate petitioner for a redetermination of its tax liability]) (*Matter of Mustafa, supra*).

B. The next issue to address is whether the Division's audit method was reasonably calculated to determine the ensuing liability.

The Tax Law, attendant regulations and extensive case law developed in connection with the collection of sales and use taxes leave it well settled that a vendor such as Nah Nah is



required to maintain complete, adequate and accurate books and records regarding its sales tax liability, and upon request, to make the same available for audit by the Division (*see* Tax Law § 1138[a]; § 1135; § 1142[5]). To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn.*, 102 AD2d 352, 477 NYS2d 858) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also*, *Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), "from which the exact amount of tax due can be determined" (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388

NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (***Matter of Scarpulla v. State Tax Commn.***, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451; ***Matter of Cousins Serv. Station***, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

The Division received no books and records in this matter, with the exception of Nah Nah's filed sales tax returns. Thus, the Division correctly concluded that the records were not adequate to perform a complete audit since, in particular, there were no source documents produced, i.e., sales invoices or purchase invoices submitted by petitioner (*see*, ***Matter of Vebol Edibles v. State of New York Tax Appeals Tribunal***, 162 AD2d 765, 557 NYS2d 678, *lv denied* 77 NY2d 803, 567 NYS2d 643; ***Matter of Club Marakesh v. Tax Commn. of State of New York***, 151 AD2d 908, 542 NYS2d 881, *lv denied* 74 NY2d 616, 550 NYS2d 276). Under these circumstances, it was not possible for the Division to verify whether sales tax had been properly paid on the purchase of fixed assets and other recurring expense purchases.

The Division presented evidence that the method it chose to determine petitioner's tax liability herein was based on error rate percentages computed on fixed asset and recurring expense purchases in a prior audit of Nah Nah. Applying these percentages to current period gross sales, the Division computed estimated additional tax due.

Petitioner maintained that the audit methodology was flawed for various reasons, including the Division's reliance on the calculations from a prior audit performed by a different auditor than in the current matter. Petitioner argued that the company did not consistently purchase fixed assets, particularly when facing corporate bankruptcy, and thus it was inequitable to make the assumption that assets were purchased during such time period. Further, petitioner explained that since the prior audit Nah Nah had made improvements in the manner in which it was paying sales tax, and had discontinued doing business with certain out of state vendors who did not, or were not required to, collect New York State sales taxes on sales to New York customers. Petitioner's arguments concerning the audit methodology are rejected.

The Tax Appeals Tribunal has held that, based on the inadequacy of the records made available by a petitioner to the auditor in similar circumstances, it found no basis to conclude that the auditor acted unreasonably in using, to the extent possible, the limited records available and then turning to the prior audit percentages to complete the current audit (*Matter of Mustafa, supra*). Therefore, the Division was authorized to resort to an external index to estimate petitioner's tax liability, particularly since it was based upon this petitioner's prior operations, and the methodology employed was reasonable. Petitioner has offered no evidence that demonstrates that the Division's methodology was erroneous or unreasonable.

At some point during the audit, the Division determined that the audit period should be extended beyond May 31, 1999 to August 31, 1999. Just as it was required to do for the original audit period, the Division was required to make an adequate demand for petitioner's books and records for the extended audit period. Here, there is no discussion of whether an additional written demand was made for production of petitioner's records for this extended

audit period, and the evidence in the record only supports a request for records up until May 31, 1999. It is clear that petitioner was not advised by the Division of an extension of the audit period beyond May 31, 1999, nor were records requested for such extended period. As a result, absent such request, the Division's estimation of tax liability for the period of the extended audit was not proper. Pursuant to *Matter of Adamides v. Chu (supra)*, the tax assessed by the Division based upon an asserted lack of books and records, for the quarter between June 1, 1999 and August 31, 1999, is canceled.

C. Penalties were imposed pursuant to Tax Law § 1145 which authorizes the imposition of penalties for failure to pay any tax imposed under Articles 28 and 29 of the Tax Law. Tax Law § 1145(a)(1)(iii) provides that if the failure or delay was due to reasonable cause and not due to willful neglect, penalty and additional interest shall be abated. Reasonable cause includes any cause for delinquency which would appear to a person of ordinary prudence and intelligence as reasonable cause for the delay in filing a sales tax return and paying the tax imposed under Articles 28 and 29 of the Tax Law (20 NYCRR 2392.1[d][5]).

Petitioner argues that his inability to provide the documents requested by the Division was due to reasonable cause, since the failure to provide such documents was beyond petitioner's control, and he made efforts to obtain the same without success, and therefore the penalties should be abated. Petitioner has not established reasonable cause for the waiver of penalties. The record shows that petitioner took only minimal steps to obtain records from the bankruptcy trustee both before and after the hearing, over the past four years. In particular, petitioner's choice to ignore the specific instructions of the administrative law judge to serve a subpoena for Nah Nah's records in accordance with certain rules, exhibited a lack of interest to have the records produced. I do not believe that petitioner was prevented from obtaining such

records by anything other than his own omissions. Accordingly, penalties assessed in this matter are sustained.

D. The petition of Hong J. Han, is hereby granted to the extent of the cancellation of the tax, penalty and interest in one quarter as noted in Conclusion of Law “B”, but is otherwise denied, and the Notice of Determination dated December 6, 1999, as modified is sustained.

DATED: Troy, New York  
January 20, 2005

/s/ Catherine M. Bennett  
ADMINISTRATIVE LAW JUDGE